BDC
Entrepreneurs first

economic LETTER

NOVEMBER 2015

MANAGING BUSINESS GROWTH: WHAT ARE THE BEST STRATEGIES?

Growing their businesses is one of the main challenges facing the owners of small and medium enterprises (SMEs). As a firm expands, its needs multiply in many areas, such as production, manpower and financing, making it far more complex to run. Although it is no easy task, many Canadian entrepreneurs are successful in meeting that challenge. They manage to overcome the obstacles that curtail their growth, thanks to winning strategies. BDC carried out in-depth interviews with 25 such entrepreneurs on this subject. The interviews served as the basis for drawing up a questionnaire used in a survey that was carried out last summer among 1,015 SME representatives. This exercise made it possible to paint a complete picture of what growth, and the challenges associated with it, represent for SME owners, and to identify some strategies that have proven effective.[1]

A fair number of SMEs post pronounced growth

Four SMEs out of 10 (41%) show sustained or strong growth (Graph 1). Medium-sized companies appear to be better able to manage their growth, compared with small firms. Over half of them (54%) have maintained a sustained or strong pace of growth over the past three years, compared with around 45% for companies with 5 to 99 employees, and 34% for microbusinesses (1 to 4 employees). It is interesting to note that the period of strong growth usually occurs during the first 10 years of a company's existence, and that it is more unusual for companies over 20 years old—a finding that is compatible with the life cycle of businesses (start up, growth, maturity). The survey results also show that the state of the economy influences the ability of businesses to grow: 23% of businesses in Alberta met the criteria for strong growth, versus 12% for all Canadian SMEs. ▼

1 Business Development Bank of Canada, October 2015, "SMEs and growth: Challenges and winning strategies".
2 To be considered growing, a company must show an increase in its earnings, profits or staff in each of the past three years, with no decline in any of those aspects. Average annual growth of 5% to 19.9% in earnings, profits or the number of employees qualifies as sustained growth, while average annual growth of 20% or more constitutes strong growth.

Canada
- GDP keeps heading up
- A rally in employment
- The trade deficit shrinks

United States
- GDP growth has slowed
- Healthy job growth
- The housing market keeps improving

Interest rates
The key interest rate is unlikely to be raised before the last quarter of 2016

Oil price

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Key indicators

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to November 7. Reliance on and use of this information is the reader's responsibility.

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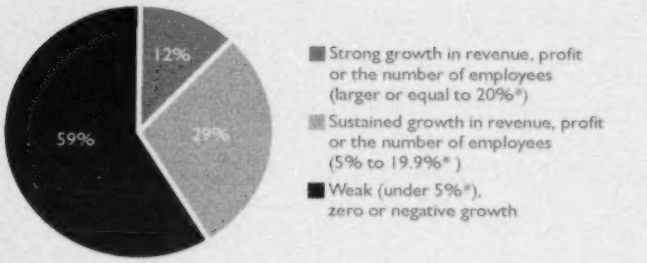
Graph I: Four out of 10 SMEs are experiencing sustained or strong growth


12%
29%
59%
Strong growth in revenue, profit or the number of employees (larger or equal to 20%*)
Sustained growth in revenue, profit or the number of employees (5% to 19.9%*)
Weak (under 5%*), zero or negative growth

Source: Ad Hoc Research, *Survey on the Growth of Canadian SMEs*, June 2015, n = 1,015

*Average annual growth over the last three years

Growth is highly valued by entrepreneurs

On a scale of 0 to 10, SME owners rate the importance of business growth at 7.1. The reason that growth is so highly valued is that owners derive benefits from it. Ninety-one percent (91%) of SME owners believe that growth enables them to improve their financial position and that of their families. Moreover, 84% consider that it increases the competitiveness of their business, and 80% believe that it gives the business better financial grounding to ensure its survival. Business leaders also feel that in many respects, growth provides many benefits to their employees. For one, it enables the company to take on larger projects, which appeals to and motivates employees; for another, it makes their work more stimulating, in particular by increasing their opportunities for advancement and promotion. Lastly, approximately three business leaders out of four consider the fact of having a greater impact in the community to be a significant advantage provided by the growth of their company.

The path of growth is fraught with many obstacles

The more a company expands, the more it costs to run it. The increase in operating costs that goes hand in hand with business growth constitutes a significant obstacle for the majority of SME owners (64%). More than half of the respondents (55%) consider that recruiting and retaining qualified employees represents a major challenge. Even though external factors—greater competition, for example—can slow growth down, it is generally issues inherent in the company, such as difficulty in managing growth in an orderly fashion or lack of knowledge about new technologies, market trends or the competition, that are considered the most important.

Four strategies have a proven track record

1-Focus on the customer

The respondents are practically unanimous on this point: to ensure the growth of their company, it is necessary to clearly understand customers and to meet their needs. Providing good service to customers and, if necessary, revising the offer of products and services to suit their needs and their expectations is an essential condition for retaining their loyalty and attracting new customers.

2-Build a winning team

Owners of growing SMEs consider that human resources management is a key factor for success. Some rely on employee training, others on hiring more qualified personnel. Owners of companies with more than five employees that are enjoying strong growth stand out by the fact that they attach greater importance to building a team of more experienced managers. During the interviews, many of the entrepreneurs said that because they were well supported, they felt more comfortable about delegating certain key responsibilities; this, in their view, made it possible to constantly push the boundaries of the company.

3-Stay at the cutting edge and innovate

Innovation, that is, the development of new products or services or the adoption of new processes and business models, is at the top of the list of strategies that promote SME growth. Eight respondents out of 10 said that their success was attributable to their ability to innovate.

4-Invest to be the best

Investment is the engine of business expansion. Three out of four respondents had taken the step of investing in expanding their facilities and acquiring new equipment to increase their production capacity. The same percentage of entrepreneurs made use of advanced technologies such as automated management systems to improve their efficiency, which helped support their growth.

SME growth guarantees the vitality of the economy

SMEs are the drivers of Canada's economy, and their growth is one of the primary keys to the vitality of that economy. The more SMEs choose the road to growth, the stronger the economy will become. By providing useful information about winning growth strategies and demonstrating the benefits to be gained by leading an expanding business, BDC hopes to encourage as many SME owners as possible to grow their companies. ■

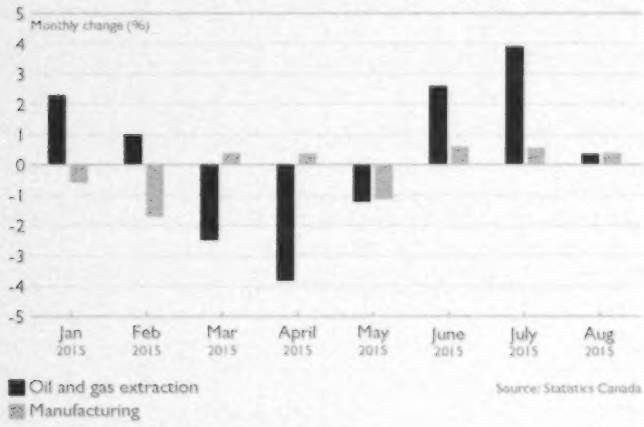
Production increased for the third straight month in August, and the trade balance data show strong growth in merchandise exports in the third quarter. These data are harbingers of a vigorous rally in economic activity in the third quarter, after contraction in the first two quarters of the year.

GDP keeps heading up

Real GDP continued growing in August, recording a gain of 0.1% compared with the previous month. Production expanded in the majority of the main industrial sectors. It was up for the third straight month in the oil and gas extraction sector (Graph). Barring an unexpected change of direction in September, we can already look forward to a fairly robust rebound in real GDP growth in the third quarter, after the pullbacks recorded in the first and second quarters of the year.

Third consecutive upturn in production in oil and gas extraction and in manufacturing

Real GDP, oil and gas extraction and manufacturing, January 2015 to August 2015



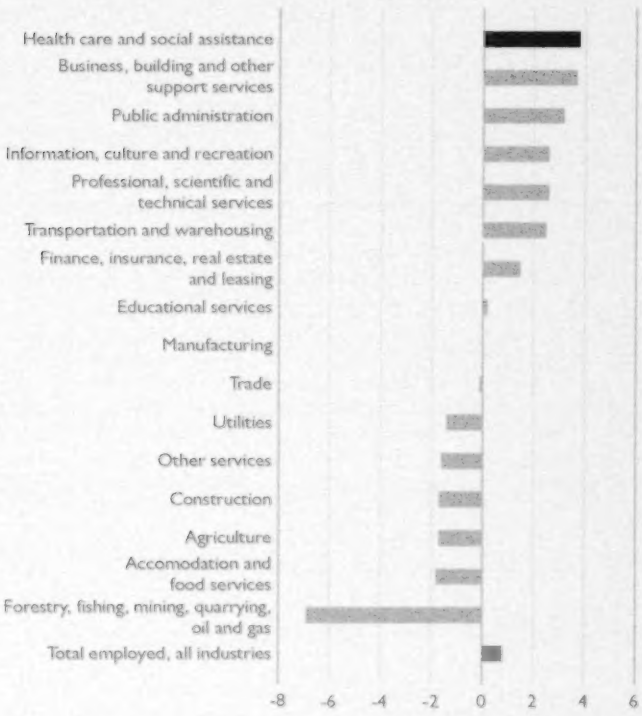
Source: Statistics Canada

A rally in employment

After holding fairly steady over the past four months, employment rebounded in October, recording an increase of 44,000 jobs. The unemployment rate dipped by 0.1 percentage point, to 7.0%. A large share of the October gain is attributable to more jobs in public administration (32,000), in particular temporary jobs associated with the federal election. It is interesting to note that in the past 12 months, employment has expanded mainly in the public sector (2.7%), while the number of employees in the private sector has edged up only slightly (0.3%), as did the number of self-employed workers (0.6%). In the public sector, the jobs upturn is mainly concentrated in health care and social assistance (Graph).

Employment expanded considerably in health care and social assistance services

12-month change in employment by industry in October 2015



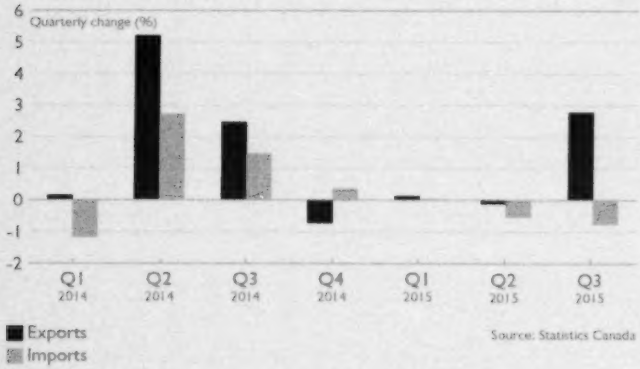
Source: Statistics Canada

The trade deficit shrinks

Imports fell by 1.3% in September compared with the previous month, while exports ticked up by 0.7%, causing the trade deficit to contract from $2.7 billion in August to $1.7 billion in September. It was imports of energy products and metal and non-metallic mineral products that recorded the largest declines in September. On the exports side of the scale, the largest gains were achieved in those same sectors, as well as in the consumer goods sector. The September data tell us that export growth rallied sharply in the third quarter (Graph), suggesting that real GDP growth was lively during that period. ▼

Exports rebounded strongly in Q3, while imports declined

Merchandise exports and imports, chained dollars (2007), Q1 2014 to Q3 2015



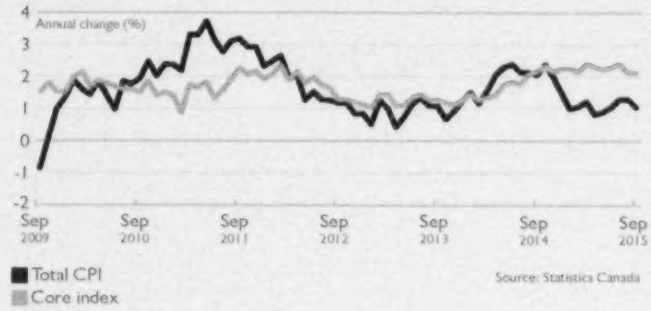
Source: Statistics Canada

The slump in gasoline prices pushes the inflation rate down

The inflation rate, measured by the 12-month change in the total CPI, has dropped markedly in the past year, from 2.0% in September 2014 to 1.0% in September 2015. This decline is due to the plunge in gasoline prices during that period (19%). As measured by the Bank of Canada's core index which excludes gasoline and seven other items whose prices are volatile, inflation stood at 2.1% in September (Graph). Contrary to the price of gasoline, the depreciation of the loonie exerts upwards pressure on inflation, since it drives up the prices of imported goods. According to economists at the Bank of Canada, the 25% depreciation of the Canadian dollar against its U.S. counterpart that has been observed since September 2012 has pushed total inflation up by around 1.0 percentage point, and inflation as measured by the core index by around 0.5 percentage point.[3] ■

The slump in gasoline prices has pushed the inflation rate down

Consumer Price Index and core CPI, September 2009 to September 2015



Source: Statistics Canada

★ UNITED STATES

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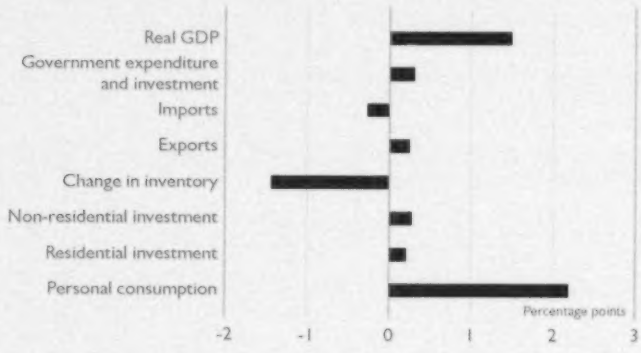
GDP growth slowed slightly in the third quarter, but is still solid. The robust job numbers in October and the ongoing improvement in the housing market bode well: the economy should keep growing at a healthy pace in the coming quarters.

GDP growth has slowed

After rallying from 0.6% in the first quarter to 3.9% in the second quarter, real GDP growth resumed a more moderate pace in the third quarter (1.5%). It was consumption that supported growth during that period. The other components made weak contributions, except for investment in business inventories, the decline of which curtailed real GDP growth considerably (Graph). In general, forecasters were anticipating slightly stronger growth in the third quarter, or around 2.0%. But they could still be proven right, as the U.S. Bureau of Economic Analysis frequently revises its initial estimate substantially. ▼

Consumption supported GDP growth in Q3, but changes in inventory pulled it back

Contributions to annualized quarterly growth in real GDP in Q3 2015



Source: U.S. Bureau of Economic Analysis

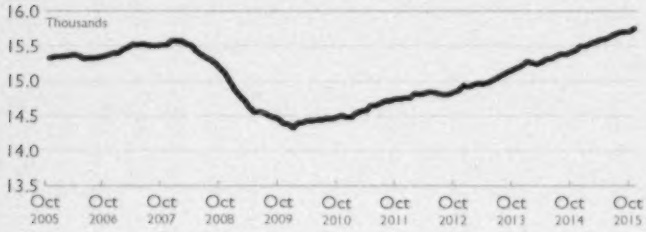
3 Laurence Savoie-Chabot and Mikael Khan, "Exchange Rate Pass-Through to Consumer Prices: Theory and Recent Evidence", Discussion Paper 2015-9, Bank of Canada, page 5.

Healthy job growth

After slowing down in August and September, job growth accelerated in October, with net job creation of 271,000, compared with an average gain of 145,000 in the two previous months. Jobs were up in most industries with the exception of oil and gas extraction. The oil price slump curbed activity in that sector, with the result that jobs have declined there by 7% over the past 12 months. In the retail sector, employment has won back the ground that was lost since the recession and is showing firm, continued growth (Graph), evidence of robust consumption. We note that the unemployment rate was unchanged in October, at 5.0%.

The retail sector boasts strong job growth

Employment, retail trade, October 2005 to October 2015



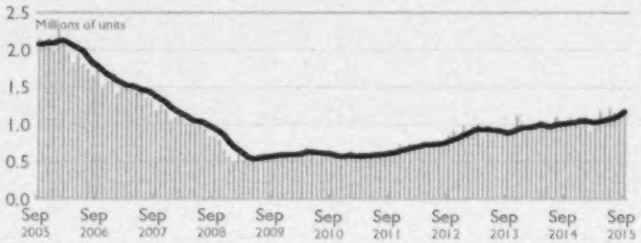
Source: U.S. Bureau of Labor Statistics

The housing market keeps improving

Things are still improving in the housing market, both for new builds and for sales of existing homes. Housing starts were up by 6.5% in September compared with the previous month. That increase comes mainly from the multiple-unit segment, where starts shot up by 17.0% in September; starts of single-family homes barely budged (0.3%). As measured by the six-month moving average, the housing start trend is on the upswing (Graph). Meanwhile, sales of existing homes have won back nearly all the ground that was lost in August, recording an upturn of 4.7% in September. At the current pace of sales, it would take 4.8 months to sell off the inventory of homes on the market. One year ago, it would have taken 5.4 months to do so. ■

The housing start trend is still positive

Housing starts and their 6-month moving average, September 2005 to September 2015



Source: U.S. Census Bureau

INTEREST RATES

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The key interest rate is unlikely to be raised before the last quarter of 2016

On October 21, the Bank of Canada decided to leave the target for the overnight rate at 0.50%, as expected. The central bank also released its forecasts for Canadian GDP growth. These were revised downwards, since the Bank believes that the price slump in oil and certain other commodities since the summer is curbing investments and exports of resources to a greater extent than expected. It now predicts that real GDP growth will be 1.0% in 2015, after which it will accelerate to 2.0% in 2016 and to 2.5% in 2017. Meanwhile, in the United States, the Federal Reserve decided to leave the federal funds target rate unchanged. The American monetary authorities hinted that they would raise the key interest rate once the labour market firms up more, provided that they remain confident of the inflation rate returning to the 2% target in the medium term. The majority of forecasters anticipate that the Canadian key interest rate will not budge before the last quarter of next year, but opinions diverge regarding the U.S. benchmark rate: some anticipate a hike by the end of this year, while others think it will not happen until the first quarter of 2016. ■

OIL PRICE

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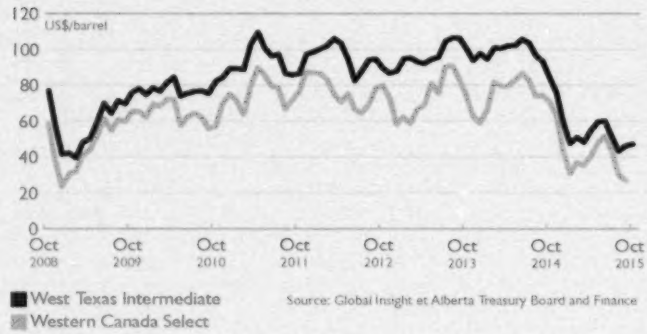
Crude oil prices remain stable

The price of crude oil (as measured by West Texas Intermediate) climbed at the beginning of October, to nearly US$50 per barrel, but it subsequently fell back. At the end of the month it was around US$46 per barrel. In terms of monthly averages, the price held steady in October compared with the month of September, recording a meagre gain of 2.1%. At the beginning of the month, statements by the Secretary General of the Organization of the Petroleum Exporting Countries (OPEC) indicating that global demand was looking stronger than expected in 2015 and 2016, while the increase in the supply from the countries outside OPEC could prove to be less than expected, sent prices heading up. But they dropped again upon the announcement of a slowdown in Chinese economic growth and a greater increase than expected in U.S. oil inventories. ■

Oil prices remained stable in October

Prices of West Texas Intermediate and of Western Canada Select, October 2008 to October 2015



Source: Global Insight et Alberta Treasury Board and Finance

CANADIAN DOLLAR

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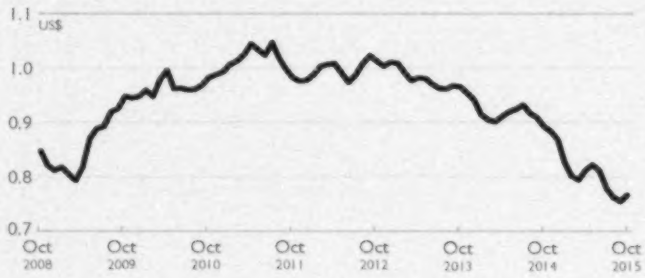
The Canadian dollar appreciates slightly

After several months of depreciation, the loonie appreciated slightly against the U.S. dollar in October. This is probably due to the fact that the latest data point to a rally in Canadian real GDP growth in the third quarter. The slight upturn in crude oil prices in October, compared with the previous month, no doubt also helped to stabilize the loonie's exchange rate against the U.S. currency. ■

The Canadian dollar appreciated slightly

Canada/United States exchange rate, October 2008 to October 2015



Source: Bank of Canada

SME CONFIDENCE

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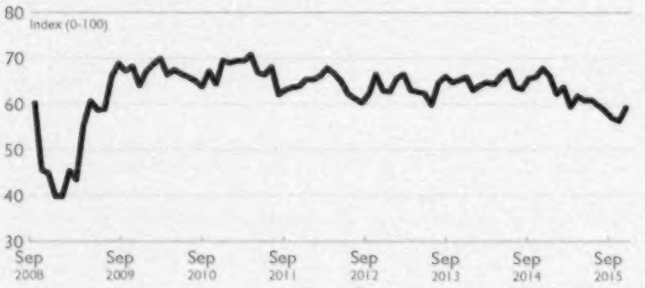
Business confidence heads up

The Canadian Federation of Independent Business's Business Barometer Index gained three points in October compared with the previous month. This is its first substantial upturn in several months (Graph). Despite that increase, it is still well below where it stood one year ago (58.9 versus 65.7). In October, business confidence rose in the construction, manufacturing and transportation sectors, but dropped again in the other main industries. Across the regions, the Barometer shows renewed confidence in 6 of Canada's 10 provinces, including Alberta where SME owners are nevertheless the least confident in the country. ■

SME confidence edges up a notch

Business Barometer, September 2008 to September 2015



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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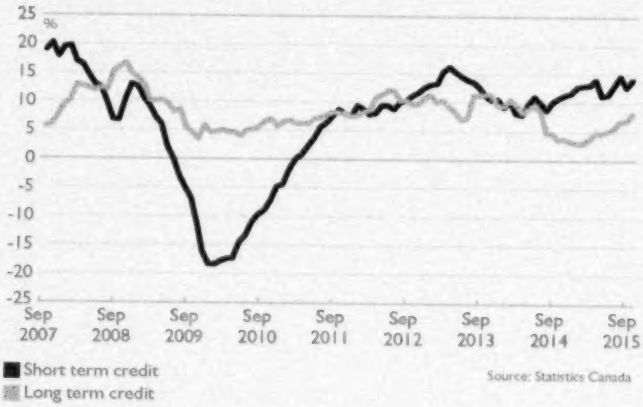
Bank credit growth accelerates

In September, bank credit expanded by 1.9% compared with the previous month, and by 13.3% compared with September 2014. In the past year, annual growth in bank credit (both short-term and long-term credit) has accelerated (Graph). Businesses continue to enjoy very favourable credit conditions, thanks to historically low lending rates. ■

Growth in bank credit (short and long term) accelerates

Annual change in short term and long term bank credit, September 2007 to September 2015



Source: Statistics Canada

KEY INDICATORS—CANADA

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Key indicators—Canada

	Historical[1]				2015[2]				2015		Forecast	
	2011	2012	2013	2014	Q1	Q2	Q3	Q4	Latest[3]		2015	2016
Real GDP (% growth)	3.0	1.9	2.0	2.4	-0.8	-0.5			Aug	0.1	1.1	2.0
Machinery and Equipment Expenditures (% growth)	8.1	1.9	1.0	1.0	-6.2	-17.1					-5.0	0.2
Pre-Tax Corporate Profits (% growth)	23.3	-6.7	0.7	10.8	-48.5	6.8					-10.2	6.5
Industrial Production (% growth)	4.1	1.4	1.8	4.1	-4.0	-9.7			Aug	0.4	-1.3	1.6
Industrial Product Prices (% growth)	6.9	1.1	0.4	2.5	-0.4	1.7	3.9		Sep	-0.3	-0.7	2.4
Non-Residential Construction (% growth)	15.9	13.5	5.0	-0.1	-23.5	-8.8						
Housing Starts (' 000 units)	193	215	188	189	175	193	213		Sep	232	190	180
Personal Expenditures (% growth)	2.2	1.9	2.5	2.7	0.5	2.3					2.0	2.0
Consumer Price (% growth)	2.9	1.5	1.0	1.9	-0.2	2.5	2.3		Sep	-0.2	1.2	2.0
Employment (% growth)	1.5	1.3	1.4	0.6	0.7	0.8	0.8		Oct	0.2		
Unemployment Rate (%)	7.5	7.3	7.1	6.9	6.7	6.8	7.0		Oct	7.0	6.9	6.8
SMEs Confidence Index (CFIB)	66.3	63.9	63.9	64.9	61.4	60.2	57.0		Oct	58.9		
Manufacturers Confidence Index (CFIB)	67.3	66.5	63.8	65.8	61.9	57.8	58.2		Oct	60.2		

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.

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